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# WHERE NEXT FOR AID?

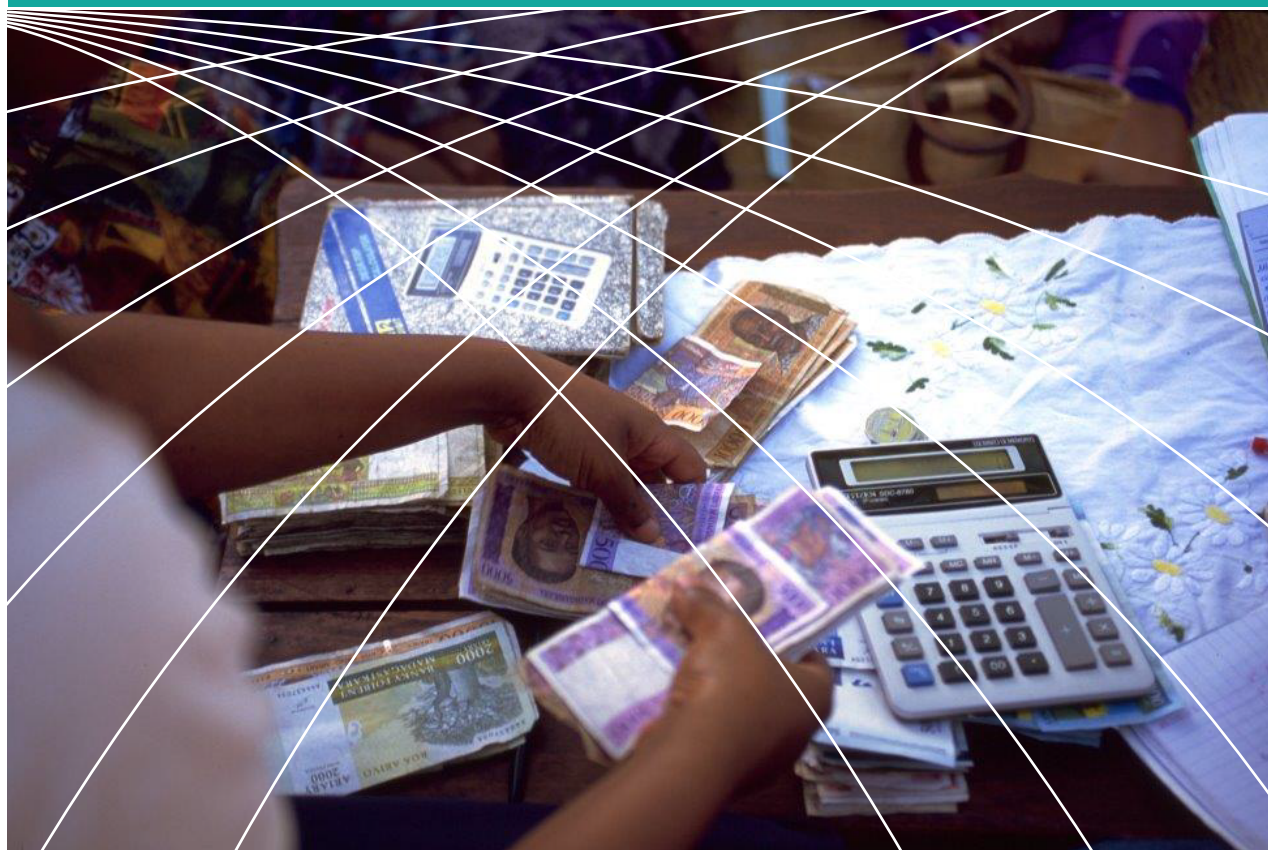
## THE POST-2015 OPPORTUNITY

### DISCUSSION PAPER

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# ABBREVIATIONS

AIDS	Acquired Immune Deficiency Syndrome
AMC	Advance Market Commitments
BRICS	Brazil, Russia, India, China and South Africa
CER	Certified Emissions Reduction
DAC	Development Assistance Committee
EC	European Commission
EU	European Union
EVI	Economic Vulnerability Index
FDI	Foreign Direct Investment
FTT	Financial Transactions Tax
GDP	Gross Domestic Product
GNI	Gross National Income
GPG	Global Public Good
HAI	Human Assets Index
HDI	Human Development Index
HIV	Human Immunodeficiency Virus
IFFIm	International Finance Facility for Immunisation
IMF	International Monetary Fund
IPCC	Intergovernmental Panel on Climate Change
IPF	International Public Finance
IPF4SD	International Public Finance for Sustainable Development
LDC	Least-Developed Country
LIC	Low-Income Country
MDGs	Millennium Development Goals
ODA	Official Development Assistance
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
OOF	Other Official Flow
PPP	Purchasing Power Parity
SDRs	Special Drawing Rights
UK	United Kingdom
UN	United Nations
UNDESA	UN Department of Economic and Social Affairs
UNDG	UN Development Group
UNDP	UN Development Programme
UNFCCC	UN Framework Convention on Climate Change
UNICEF	UN Children's Fund
UNIDO	UN Industrial Development Organization
UNU	UN University
US	United States
WIDER	World Institute for Development Economics Research

# FOREWORD

***Olav Kjørven (UNDP) and Kevin Watkins (ODI)***

Development aid has played an important, if sometimes imperfect, role in furthering international development objectives, including the historic Millennium Development Goals (MDGs). As the MDG era draws to a close and the world debates a new, post-2015, sustainable development agenda, we are in no doubt it will continue to play a key role in the future.

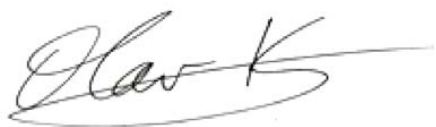
But we live in different times. And in new times come new opportunities and new challenges. With important development progress being made in most regions of the world, developing countries are now able to mobilize more domestic resources and can access a diverse and sophisticated range of private capital flows. Some are (re-)emerging as important development funders themselves.

This has led some to question the continued importance of development aid, arguing that more countries than ever before are in a position to fund their own development. The anticipated increased role for the private sector in development is welcome, but, as this paper shows, international public finance will still have a vital and unique role to play in the future.


In this context, we are delighted to recommend this timely discussion paper. Building on an analysis of the unique qualities not just of aid but of international public finance more broadly, and assessing the new context and challenges facing the world, it makes a compelling case for taking some important “next steps” in international financial cooperation.

Rather than focusing just on aid, the authors argue that the concept of international public finance for sustainable development is more coherent with today’s world. They call for establishing such financing on a permanent basis, and allocating it according to a much broader set of criteria rather than concentrating simply on income per capita. And they discuss the governance evolutions required in multilateralism to make such an ambitious project work for people and planet.

As discussions about the post-2015 sustainable development goals turn increasingly to practical questions of implementation, this paper makes an important contribution. It will provoke debate and discussion, and we encourage others to build on the ideas it contains.



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# EXECUTIVE SUMMARY

The world is engaged in an energetic conversation on a post-2015 development agenda. UN-led consultations have shown people want an ambitious agenda that tackles the “old” Millennium Development Goal (MDG) issues such as education and health, but that also addresses environmental degradation, inequality, governance and other issues. Governments’ policy choices – at both domestic and international levels – will be the most important enabler of progress towards the new sustainable development agenda. But there can also be little doubt that whatever vision finally emerges, it will be extremely expensive to fulfil. So, how should it be financed?

This paper looks at whether development aid will remain important and relevant in the post-2015 era, and asks how it should evolve in response to a new international context.

## *Where does international public finance fit in?*

High expectations are being placed on domestic resources and on private capital to play an increasingly important role in the financing of sustainable development in the post-2015 era. These sources of finance are often touted as substitutes – or near-perfect substitutes – for the various types of international public finance (IPF) and, in particular, development aid. However, it is the distinct *qualities* of IPF, rather than just its quantity, that make it so crucial to future sustainable development efforts.

Most private capital is motivated by profit. It tends not to be oriented towards poverty eradication and environmental sustainability concerns, and it remains concentrated in specific sectors (such as natural resource exploitation) and specific countries (those richer in income and resources). For the least-developed countries (LDCs) in particular, aid remains the most important source of external finance.

IPF can help correct for these market failures. But this is not its only role. It can also help drive forward investments and progress in critical areas such as research, innovation, new technologies and sustainable infrastructure. It can be used to fund riskier interventions, leverage additional private capital and respond at scale in moments of crisis. And it has a unique role in funding global and regional public goods.

So IPF remains important. But is the theory behind it, and the structures that govern it, fit for purpose for the post-2015 era?

## *New era, new development thinking*

Modern development aid has its origins in the immediate post-World War II era. The current aid paradigm is centred around the basic idea that aid represents a short-term transfer from the “haves” to the “have nots”; once the poor “catch up” (or converge) with the rich, development aid will no longer be needed. The current approach also focuses on “development” as a process that occurs (mostly) within the boundaries of nation states. How relevant is this model for today’s realities?

Over the past decade, the developing world has been driving global economic growth. Much attention has focused on the rapid economic advances some of the largest countries have made, but there has also been substantial progress in smaller economies. High, sustained growth across large parts of the developing world has helped lift millions of people out of poverty over a relatively short period of time; some estimates suggest there could be as few as 16 low-income countries by 2030.

Economic resurgence has been accompanied by major shifts in geopolitical power and influence. This has enabled greater economic independence from major aid donors, as countries are able to mobilize more domestic resources and access private capital markets. Developing countries now absorb more foreign direct investment (FDI) than high-income countries and several middle-income countries have become important international donors themselves. A more nuanced and complex range of development situations has now replaced a neat division of the world into “developed” and “developing”.

These major economic and political transformations are taking place at a time when the concept of “sustainable development” is emerging as the major framework for development thinking and practice, replacing the tight focus on poverty reduction and social progress under the MDGs. One of the most important implications of this is that the problem now being discussed (unsustainable development) is located in *all* countries, rich and poor alike. Addressing it will require profound structural transformations across countries of *all* income levels with differentiated levels of responsibilities. It will also require the mobilization of unprecedented levels of finance *over the long term* and collective international action on an immense scale.

What do these changes mean for development aid and IPF in the post-2015 era?

### ***From “aid” to “international public finance for sustainable development”***

The simplistic concept of “development aid” has long been questioned. Today, as incomes across the developing world rise and as development aid budgets are increasingly tapped to fund a whole host of other areas such as climate change adaptation and mitigation and global public goods (GPGs), it is important to ask whether the broad range of functions IPF is *already performing* can be described – and counted – as development aid. Some transfers (e.g. funding for GPGs) represent as much an investment in the common interest as a transfer from “rich” to “poor”.

Instead, “development aid” is a subset of official financial flows that can be gathered under the larger and more relevant label of ***international public finance for sustainable development – IPF4SD***. It is these flows that will acquire more prominence and that are likely to constitute the bulk of development finance transactions in the post-2015 era and beyond, helping usher in new paths to sustainable and inclusive development for *all* countries.

The transition from aid towards IPF4SD raises many challenging questions. For instance, how should funds be allocated geographically and thematically (e.g. to “traditional” development aid, climate finance, GPGs or research and science)? Should there be targets? And should all countries contribute to IPF4SD, taking into consideration the principle of common but differentiated responsibilities? How should contributions to IPF4SD be measured, and by which entities?

### ***International public finance for sustainable development in the post-2015 era***

Increased wealth means more countries will be able to contribute resources to help finance international sustainable development objectives in the future; indeed, this is already happening. More finance could therefore be made available to address major global concerns. This is good news. But it also implies serious efforts will be needed in the post-2015 era to make the overall architecture for IPF4SD more coherent, modern and representative. It will be important for *all* countries to have a stake in defining the objectives and modalities of IPF4SD and the international norms and standards that govern it.

The need to scale up environmental responses in the post-2015 era will require major changes in investment priorities, with a much bigger role for longer-term and riskier expenditures. IPF4SD will need to focus on supporting the transition to more sustainable low-carbon models of development as well as building climate resilience and funding other global and regional public goods. Income per capita will be a less relevant determinant of countries’ eligibility for international public



funds; focus will turn to where resources can have the biggest impact at the lowest cost. Funding for new technologies, research, science and innovation will be essential – and will need to be scaled up – to drive the structural transformation that is needed.

At the same time, there are countries that continue to present special and longstanding development challenges and that will still require more traditional forms of development support in the post-2015 era. If extreme poverty is to be eliminated by 2030 – as many international bodies have pledged – it will be important to ensure development aid is not reduced as expenditures in other areas are scaled up.

### ***Raising resources***

Consideration needs to be given to how to increase the resource envelope for IPF4SD in a more predictable manner. Innovative sources of development finance have been small in scale to date, but should be scaled up in the future. Within the post-2015 agreement, governments could commit to experimenting on a voluntary basis with coordinated innovative taxation schemes and to use these taxes (or specified portions) for international cooperation.

At the same time, governments need to think about how voluntary commitments on IPF4SD can be made as stable and predictable as possible in the post-2015 era. Is setting international targets the most effective approach for mobilizing the resources needed over the long term? What are the lessons learned from peer review mechanisms, and are there alternatives to moral suasion?

IPF4SD also needs to be much better targeted in the post-2015 era. Income per capita currently influences decisions on how and where to allocate development aid. However, despite similar income per capita levels, countries can have very different capacities to mobilize domestic and external resources. They also differ in their economic and environmental vulnerabilities, and in their social indicators.

One option is to base the choice of instruments and the allocation of IPF4SD on precisely these capacities. The mix of concessional and non-concessional resources would therefore be tailored to countries' specific circumstances.

Allocation decisions should also take into account social indicators (such as those contained in the UN Development Programme (UNDP) Human Development Index or the UN's Human Assets Index) as well as environmental vulnerabilities (UNEP's Environmental Vulnerability Index could be one measure). These should be combined with income per capita to provide a more holistic picture of countries' specific needs.

### ***Getting the governance right***

Finally, the "scaffolding" matters. If the post-2015 agreement is to have the strongest possible chance of success, important changes will be needed in the architecture that mediates IPF4SD, to make it more coherent, efficient and representative.

In practical terms, this implies a greater role for large-scale pooled disbursement arrangements in the post-2015 era. Large-scale international funds in areas such as climate change adaptation and mitigation, science, research and new technologies, infrastructure development, agriculture and nutrition and GPGs could all have an important role in underpinning the structural transformation needed to move the world towards a more just and sustainable future.



This does not necessarily require new international initiatives or new vertical funds. Instead, it requires the *consolidation* and *continuous improvement* of large-scale multilateral funds combined with a commitment from countries to channel increasing resources through these mechanisms (specific targets to be achieved within a specified timeframe could be considered). It also requires a review of the mandates, governance structures and effectiveness of existing multilateral institutions and initiatives.

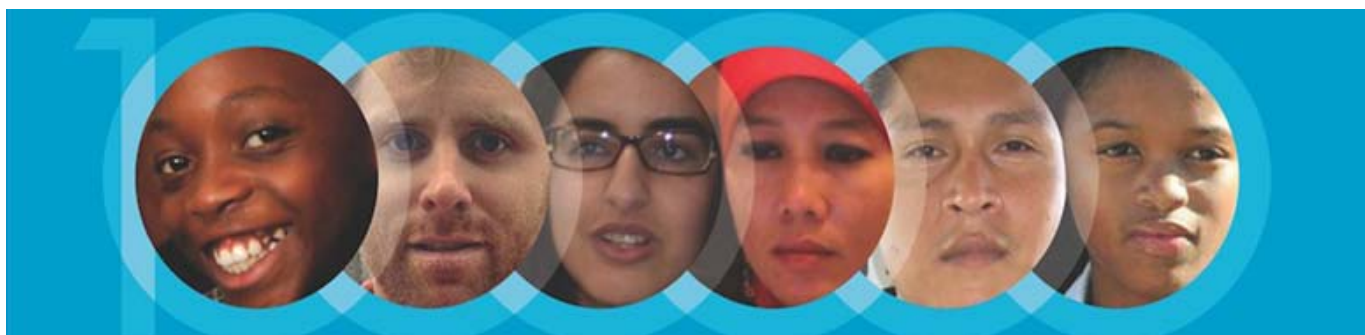
### ***The post-2015 opportunity***

The post-2015 process represents an important opportunity to build development finance institutions that represent *all* constituencies, are well resourced and deliver high-quality finance that supports internationally agreed objectives. This will not be easy, but international collaboration on the post-2015 sustainable development agenda has shown there is an enormous appetite – from all stakeholders – to build a shared vision for the future.

In this paper, we lay out what is, in our view, a strong case for IPF to fund sustainable development objectives for the foreseeable future. It will not be “development aid” in the strict sense of the term; it will be less about “donors” and “recipients” and more about a common investment between equals in support of the common interest.

It’s an ambitious agenda but one worth pursuing.

***The UN Development Group (UNDG) has collected the perspectives on the “world we want” post-2015 from almost 2 million people around the globe.***



#amillionvoices

# INTRODUCTION

***“A new spirit of solidarity, cooperation, and mutual accountability [...] must underpin the post-2015 agenda. This new partnership should be built on our shared humanity, and based on mutual respect and mutual benefit”***

*(UN High Level Panel Report on Post-2015, May 2013)*

The global conversation on what should succeed the UN's Millennium Development Goals (MDGs) when they expire in 2015 has begun in earnest. Recent UN-led consultations – collecting the views of almost two million people around the world – show people want an ambitious agenda that tackles the “old” MDG issues (such as health and education) but also addresses in a much more explicit manner environmental degradation, inequality, insecurity, governance and other issues.<sup>1</sup>

The MDG framework – and the Monterrey Consensus on Financing for Development that followed – recognized that *all* countries share in the responsibilities for development. In these agreements, developed countries promised to increase aid, cancel debt and liberalize trade. The developing world, in turn, made commitments to improve governance, mobilize more domestic resources for development and improve the local investment climate.

All sources of finance – public and private, domestic and external – were recognized as important. Private international capital flows, and in particular foreign direct investment (FDI), were acknowledged as vital complements to development efforts funded through national resources and international public finance (IPF), including development aid. Progress was to be supported, in turn, by the development of a fairer multilateral trade regime, as well as by reforms to the international financial architecture.

Since then, the world has changed. Impressive progress has been made against the MDGs, and some goals have even been met ahead of schedule. The past two decades have seen the largest reduction in extreme poverty in history.<sup>2</sup> But this progress has been uneven *between* and *within* countries, as well as across the goals.

Major changes have also taken place in economic and geopolitical power and influence. Environmental concerns – and in particular climate change – are now recognized as more urgent than ever before. In a highly interdependent world, countries at *all* income levels are exposed to major upheavals, such as financial and economic crises, that have their origins in other parts of the world. As environmental degradation accelerates and climate change intensifies, vulnerabilities to manmade environmental disasters and extreme weather events have increased. At the same time, nations continue to strive for improved standards of living, fuelled, for the most part, by traditional carbon-intensive forms of industrial development.

Meanwhile, the sources of finance that can help meet these challenges have also evolved. Domestic resource mobilization capacities have increased in the developing world, and more countries are now prominent destinations for international private capital flows. Financial products and services have also become more sophisticated and diversified.

Domestic revenues in the developing world reached US\$ 7.7 trillion in 2012, having increased by, on average, 14 per cent annually since 2000 (UN, 2013a). FDI to the developing world is expected to reach US\$ 800 billion in 2014 (World Bank, 2013a).<sup>3</sup> More developing countries are now able to access international capital markets on favourable terms. Migrant remittances have also increased, and were estimated at more than US\$ 414 billion in 2013 (ibid.).

***The UN High-Level Report on Post-2015 set out a vision for development in the post-2015 era based on five transformative shifts: 1) leave no-one behind; 2) put sustainable development at the core; 3) transform economies for jobs and inclusive growth; 4) build peace and effective and accountable institutions for all; and 5) forge a new global partnership for development.***

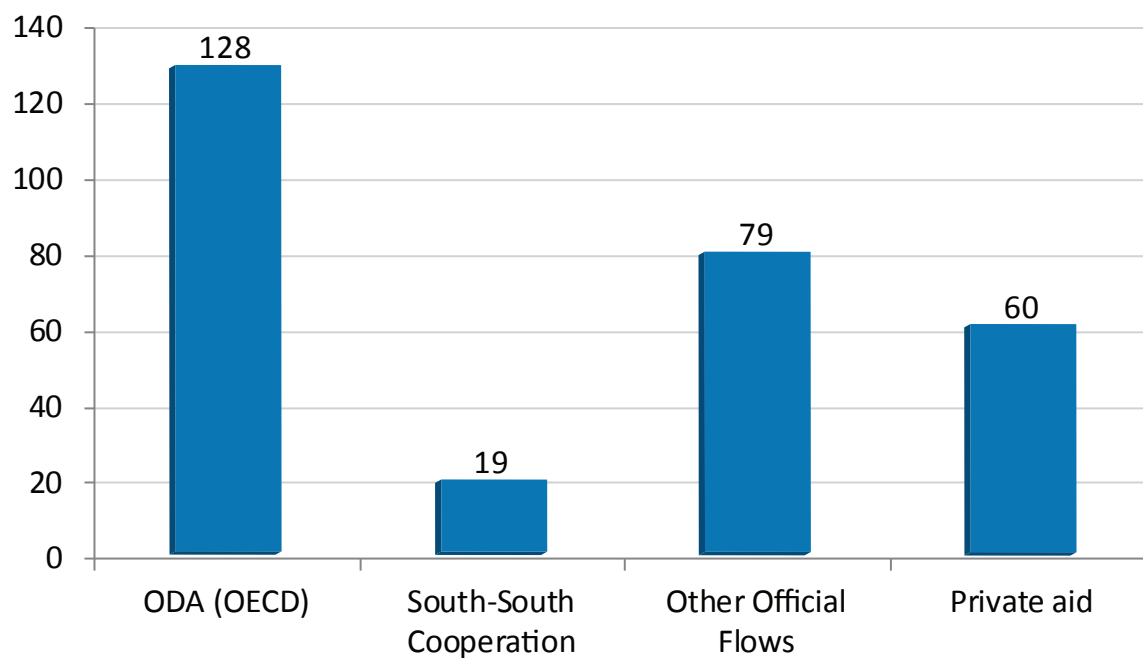
Development aid has also increased, and the number of providers – public and private – has expanded. In 2013, aid from member countries of the Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development (OECD) reached US\$ 134.8 billion, its highest ever level in absolute terms, up from US\$ 53.9 billion in 2000 (OECD, 2014). Financial and technical assistance from emerging economies (so-called “South–South Cooperation”) has also increased. Data are incomplete, but the World Bank estimates that, in 2011, concessional flows from emerging economies to low-income countries (LICs) were between US\$ 12 billion and US\$ 15 billion. Private aid (e.g. from foundations, corporations, organizations, individual volunteers, universities and religious organizations) has also expanded, and now amounts to an estimated US\$ 60-70 billion per year (World Bank, 2013a).

We must consider how we meet the challenge of “paying for post-2015” in the context of these major shifts – in both the challenges we face as well as the sources of finance we have to meet them.

This paper looks at one part of the equation: the role of IPF, including development aid, in supporting the post-2015 sustainable development vision. Does development aid – and IPF more broadly – remain important and relevant, given other, much larger, sources of finance? Does the current development aid business model, with its historical emphasis on “convergence” and short-term transfers from “rich” to “poor”, remain relevant in the post-2015 period and beyond? And can the current architecture for development aid and IPF respond effectively to the most important sustainable development challenges of the post-2015 era?

The post-2015 dialogue provides an opportune moment to reflect on these major questions. It also provides a space to chart viable ways to improve current approaches. The paper ends with a series of proposals we believe are logical “next steps” in the evolution of the international cooperation endeavour. The aim of this paper is to offer an intellectual contribution to the ongoing debate on financing for post-2015.

Fig. 1: A snapshot of aid and “aid-like” flows (public and private), 2012 (US\$ billions)



Source: Authors' elaborations based on OECD and World Bank data (2013).



## 2. INTERNATIONAL PUBLIC FINANCE: WHAT IS IT AND WHY DOES IT MATTER?

High expectations are being placed on the private sector to make a much larger contribution to the financing of sustainable development in the post-2015 era. This reflects, in part, the rise in “neoliberal” theory over the past three decades, which has emphasized an enhanced role for the private sector and a reduced role for the state in society. However, it also reflects the magnitude of international private capital flows next to international public flows; for middle-income countries (MICs), IPF comprises just 1 per cent of overall international financial flows (EC, 2013). Reorienting even a small proportion of private flows towards sustainable development objectives could have an enormous positive developmental impact (UN, 2013b).

International financial flows have also become more sophisticated and diversified, and now include FDI, equities, bonds, risk mitigation instruments, public and private concessional and non-concessional resources, “blended” public and private instruments, coordinated international taxation schemes and much more. Developing countries now live in a “new age of choice” as far as options for development financing are concerned (ODI, 2013). But this new age can also be more complex to navigate.

Against this backdrop, does IPF, and in particular development aid, remain important in the post-2015 era?

### 2.1 What is international public finance?

IPF includes financial interventions by a nation state, or by a multilateral organization acting on behalf of nation states, to secure desired public policy outcomes outside the boundaries of that state. It can consist of:

- Grants, i.e. transfers made in cash, goods or services for which no repayment is required;
- Loans (on both concessional and non-concessional terms);
- Equity investments (often directed at the productive sectors); and
- Guarantees.

IPF can have a range of objectives, from supporting poverty reduction, sustainable development and addressing humanitarian crises, to primarily commercial and/or geopolitical strategic objectives. IPF also supports macroeconomic stabilization (through, for instance, the operations of the International Monetary Fund – IMF – or similar regional entities). It can be blended with domestic public finance and also private domestic and external finance.

Development aid represents just one (albeit important) category of IPF. The OECD developed the dominant contemporary definition of development aid – “official development assistance”, or ODA. This definition dates from 1972, and is fairly broad and open to interpretation.<sup>4</sup> It is currently under review within the OECD DAC, and it is expected that a new, broader, measure will replace it, possibly called “official development effort”, from 2015.

There are no other formal definitions of development aid; non-OECD donors are free to define “aid” as they choose. Indeed, some emerging economies do not report, or describe, their activities in other developing countries as “aid”. Instead, the term “South–South Cooperation” has emerged to describe a heterogeneous mix of aid-like and non-aid-like interventions that bundle investment, trade, concessional and non-concessional finance and technical assistance under the same label (UNDP, 2013).

The OECD also uses the term “other official flows”, or OOFs, to describe transactions by the official sector with developing countries that either are non-concessional in nature or do not have development as their main aim.<sup>5</sup> These flows, which have similarities to some South–South Cooperation modalities, have been more volatile but have increased over recent years.

IPF is therefore used to perform a broad range of functions in a wide range of situations across countries at *all* income levels.<sup>6</sup>

## **2.2 Much ado about little? Does international public finance matter?**

In absolute terms, IPF cannot compete with other, much larger, sources of funds. However, it is not so much the volume of IPF as the qualities of these funds that make them so important for sustainable development.

Discussions around development often overlook the fundamental distinction between “private” and “public” funding, with “financing gap” models tending to treat all monies as fungible, although different sources of finance have unique objectives and distinct characteristics.

Despite important (and welcome) growth in social finance initiatives over recent years (such as impact investments), such practices are still far from the mainstream (UN, 2014).<sup>7</sup> Most private capital remains driven by the profit motive. It is therefore concentrated in specific sectors (such as natural resource extraction and exploitation of comparative advantage in labour-intensive industries) as well as in certain countries (those richer in income and resources), where expected returns on a risk-adjusted basis are higher (UN, 2013b).

This means several areas crucial for sustainable development attract insufficient private financing. These include financing for social services, long-term investments (e.g. in infrastructure), high-risk investments (such as research, science and new technologies and financing for small and medium-sized enterprises) and financing for GPGs (such as preserving the global commons).

Some *countries* also struggle to attract external private capital. These include the poorest countries, resource-scarce countries and some small states. Factors such as small size, limited export and production bases and/or limited capacities all influence the extent to which countries are attractive destinations for private external capital flows. In such cases, IPF, and in particular development aid, is the most important source of external finance. For the least-developed countries (LDCs), aid represents, on average, around 70 per cent of total external finance (OECD, 2013).

Moreover, international capital flows have become shorter-term and more speculative in orientation over recent decades.<sup>8</sup> Much private finance is therefore not oriented towards long-term development needs; indeed, in some cases, “hot money” flows have accentuated countries’ vulnerabilities to economic and financial crises.

In some circumstances, measures to mitigate risk, share risk and increase investment reward (through, for example, co-financing arrangements, subsidies or guarantees) will encourage private investment in countries and/or sectors considered higher risk or unprofitable. Supporting countries to develop “investment grade” policies will also help catalyse more private sector finance over the long term (UNDP, 2011). However, even with such measures in place, IPF will remain critical.



Often, IPF will be available when other sources of finance are not, as noted above. Where private capital flows are pro-cyclical, IPF performs an important counter-cyclical function, as the most recent financial crisis has demonstrated.<sup>9</sup> IPF can also be used to leverage resources from the private sector. In some cases, private capital is available but it is not affordable and/or provided at maturities that would enable countries to make longer-term investments in critical areas such as infrastructure. In humanitarian crises, both multilateral organizations and bilateral agencies have developed significant capabilities and expertise to respond to what are often complex emergencies. The public sector is also able to respond with the scale of finance needed, and these funds can often be mobilized at speed.

Through IPF, recipients can also obtain resources with specific characteristics, such as access to technical expertise and knowledge networks. It can also be used to fund riskier interventions, which governments would find difficult to justify with scarce domestic public resources. In these circumstances, it is more flexible than domestic public funds.

Domestic resources and private external capital should not, therefore, be seen as substitutes for IPF; instead, different forms of capital should be seen as important *complements* (UN, 2013a).

There are, of course, numerous examples of both successes and failures in IPF interventions, just as there are for activities supported with private funds. It is important to learn from past experiences and to make sure future interventions are as effective as possible. These analyses will be crucial to building a better IPF model for the post-2015 era.





### 3. DEVELOPMENT AID IN A NEW WORLD

*“We must embark on a bold new programme for making the benefits of our scientific advances and industrial progress available for the improvement and growth of underdeveloped areas”*

*(Truman, 1949)*

more than ever before, while debates about aid effectiveness have never been laid to rest (Deaton, 2013; Easterly, 2007; Gates, 2014; Glennie, 2008; Sachs, 2012).

In its origin, development aid was conceived of as (mostly) a bilateral exercise. Aid was extended by just a handful of “rich” countries in support of “poor” countries when the world was more easily characterized by a “rich–poor,” “developed–developing,” divide. “Development” was also understood as a process that occurred (mostly) within the boundaries of nation states, and aid (at least in the official narrative) supported a process of convergence with the high-income world. According to this logic, donors should reduce or end aid to countries as they become richer, and, indeed, recipient countries’ gradual transition out of aid remains a key objective for most bilateral donors; the litmus test of aid’s success is that it becomes redundant.

Over time, the number of development aid donors (public and private) has mushroomed. There are now 28 OECD DAC donors and a whole host of other non-OECD DAC public aid providers. Some private aid donors have also become influential international development actors.

At the same time, the number of “problems” aid is expected to “fix” has increased considerably. Aid is now assigned to areas as diverse as funding for social services; support for developing trade and productive capacities; governance and institution building; conflict prevention and management; and global collective action problems (such as preventing the spread of communicable diseases, tackling climate change and protecting the environment). Donors’ attention has also turned to ways to use aid to leverage private capital, and it has been used to provide subsidies to the private sector to incentivize it to invest in the developing world. It has also been used to cancel developing country debt and pay for refugee-associated expenditures in donor countries as well as a host of other areas. In many cases, there is no actual transfer of resources from one country to another (Coppard et al., 2013).

It has become clear that, despite the *official* narrative that surrounds development aid, in practice it is used to serve a wide range of political, commercial, cultural and moral objectives (Severino and Ray, 2009). There are important differences between individual donors – and over time – but many studies emphasize that donor self-interest plays a role in the allocation of development aid (see, for example, Alesina and Dollar, 2000, and Hoeffler and Outram, 2008).

#### 3.1 Development aid: the story so far

Development aid is one of the most important components of IPF, and has undergone numerous evolutions over the past five decades. In 2013, ODA (aid from the OECD DAC donors) reached its highest level ever in absolute terms, at US\$ 134.8 billion (OECD, 2014).<sup>10</sup> The paradox is that its usefulness (at least to some countries) is being questioned

These considerations help explain the pattern of aid distribution across countries and at different periods in time. The data show that development aid is concentrated heavily in a small number of countries; in 2011, the “top 10” recipients captured 38 per cent of all OECD DAC providers’ development aid, and the “top 20” 55 per cent (UN, 2013b). For various reasons, some countries are more important to donors than others, and it remains a challenge to persuade some to meet international commitments to increase aid to certain countries (the promise to allocate between 0.15 and 0.2 per cent of GNI to the LDCs was met by just eight OECD DAC donors in 2012 (UN, 2014)).

The diverse motivations behind development aid also help determine its development effectiveness and mean “technical” fixes – such as the OECD’s “Paris-Accra-Busan” aid effectiveness principles – can only achieve so much and have been met, in practice, with mixed results (OECD, 2014; see also OECD and UNDP, 2014).

Meanwhile, the emergence of new bilateral providers, and the re-emergence in force of other longstanding contributors such as China and India, has increased the amount of support available but also thrown into sharp relief the complex motives and objectives behind IPF, and development aid in particular.

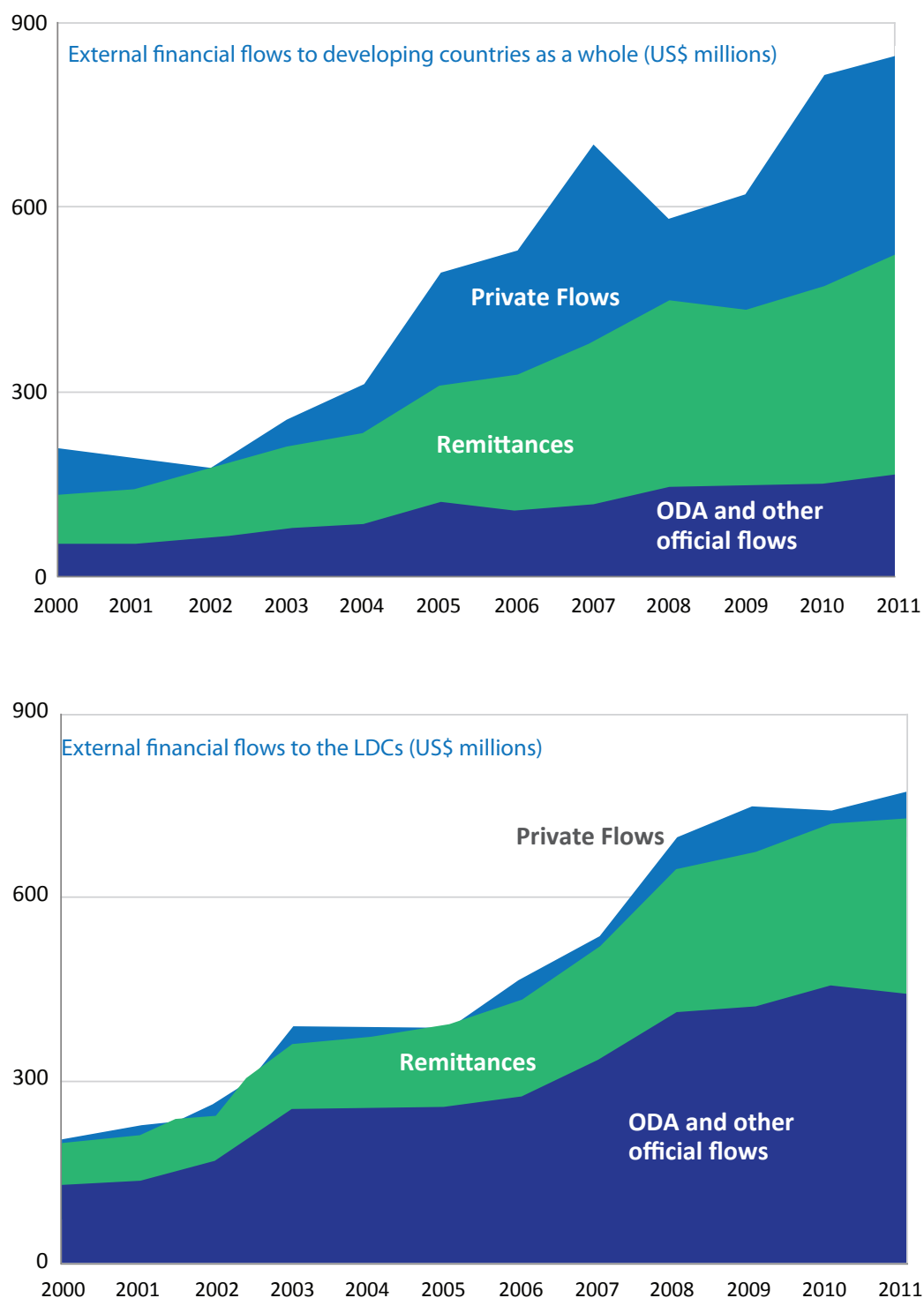
In this section, we ask to what extent the “traditional” development aid paradigm (one in which aid represents a temporary transfer from “rich” to “poor” in support of convergence of the nation state) remains relevant in today’s world. We review recent, and ongoing, shifts in geopolitical wealth and power as well as the changing nature of global challenges, and explore what these mean for the future of development aid and IPF.

**Table 1: Aid concentration – top recipients of bilateral aid, 2011**

	ODA receipts (US\$ m)	GNI per capita (US\$)	Population (m)	ODA per capita (US\$)
Afghanistan	6,384	470	29	219
Democratic Republic of Congo	5,216	190	64	82
Ethiopia	3,364	370	89	38
Pakistan	3,341	1,120	176	19
Viet Nam	3,268	1,270	88	37
India	3,014	1,420	1221	2
Kenya	2,342	820	42	56
West Bank and Gaza	2,301	-	4	586
United Republic of Tanzania	2,294	540	46	49
Mozambique	1,921	460	25	78
Iraq	1,829	2,640	32	58
Nigeria	1,716	1,280	164	10
Ghana	1,713	1,410	25	69
Haiti	1,625	700	10	162
Uganda	1,489	510	35	42
Bangladesh	1,398	780	153	9
Côte d’Ivoire	1,349	1,090	19	70
South Africa	1,214	6,960	52	24
Mali	1,196	610	14	83
Rwanda	1,190	570	11	107
Top 10 (total)	33,445	-	-	-
Share of total ODA (%)	38	-	-	-
Top 20 (total)	48,164	-	-	-
Share of total ODA (%)	55	-	-	-

Source: Authors’ elaboration based on UN (2013b) and World Development Indicators 2014.

Fig. 2: The tyranny of averages – the composition of external financial flows to developing countries as a whole versus the LDCs (US\$ millions)



Source: UN (2013a).

***“Emerging powers in the developing world are already sources of innovative social and economic policies and are major trade, investment, and increasingly development cooperation partners for other developing countries”***

*(Helen Clark, UNDP Administrator, 2013)*

the rapid economic advances some of the largest countries have made, notably Brazil, China, India, Indonesia, Mexico, South Africa and Turkey. But there has also been substantial progress in smaller economies, such as Bangladesh, Chile, Ghana, Mauritius, Peru, Rwanda and Tunisia (UNDP, 2013). High, sustained growth across large parts of the developing world has helped lift millions of people out of extreme income poverty over a short period of time.

For the first time in 150 years, the combined output of the developing world’s three leading economies – Brazil, China and India – is about equal to the combined gross domestic product (GDP) of the G7. This represents a dramatic rebalancing of global economic power; by 2050, Brazil, China and India are predicted to account for 40 per cent of world output (UNDP, 2013). Dramatic improvements in economic growth, poverty reduction and governance have also taken place across Sub-Saharan Africa over the past decade; some estimates suggest there could be as few as 16 LICs by 2030 (Sumner, 2013a).

Over the next 15 years, the developing world will dominate global savings and investment. In 2012, developing countries held 46 per cent of global savings; by 2030, this share is predicted to rise to 62 per cent (World Bank, 2013a). This implies that future foreign investment will also increasingly emanate from the developing world.

Robust and sustained economic growth in the developing world has enabled greater economic independence from the major aid donors, as countries are able to mobilize more domestic resources for development as well as access private capital markets. This has translated into more freedom from the conditionalities both bilateral and multilateral funders often impose.

Several countries have also developed or expanded their own IPF programmes, some of which are called aid programmes, others not. Indeed, some have become major financial contributors to international development as well as centres of technical expertise in areas such as agriculture and information and communications technologies. Though far from a new phenomenon, “South–South Cooperation” has expanded over the past decade and developing countries are now as interested in building political and commercial relationships with emerging economies as they are in working with “traditional” donor countries.

Economic resurgence has been accompanied by major shifts in geopolitical power and influence. The G20 has eclipsed the G7/8 as the world’s premier forum for consultation and cooperation on global economic issues (although questions still remain as to its overall effectiveness). Large developing countries are increasingly insisting on their right to contribute to the rules that dominate world trade, finance and investment.

Confidence in old forms of multilateral cooperation and in the governance structures of international institutions (such as the Bretton Woods institutions) has declined. *Regional* development banks and *regional* financial institutions, meanwhile, have taken on a more prominent role, and new forms of regional and “like-minded” cooperation are emerging (for example, in 2013, the BRICS nations (Brazil, Russia, India, China and South Africa) announced plans to establish a BRICS Development Bank and special reserve fund).

### **3.2 The end of “North” and “South”?**

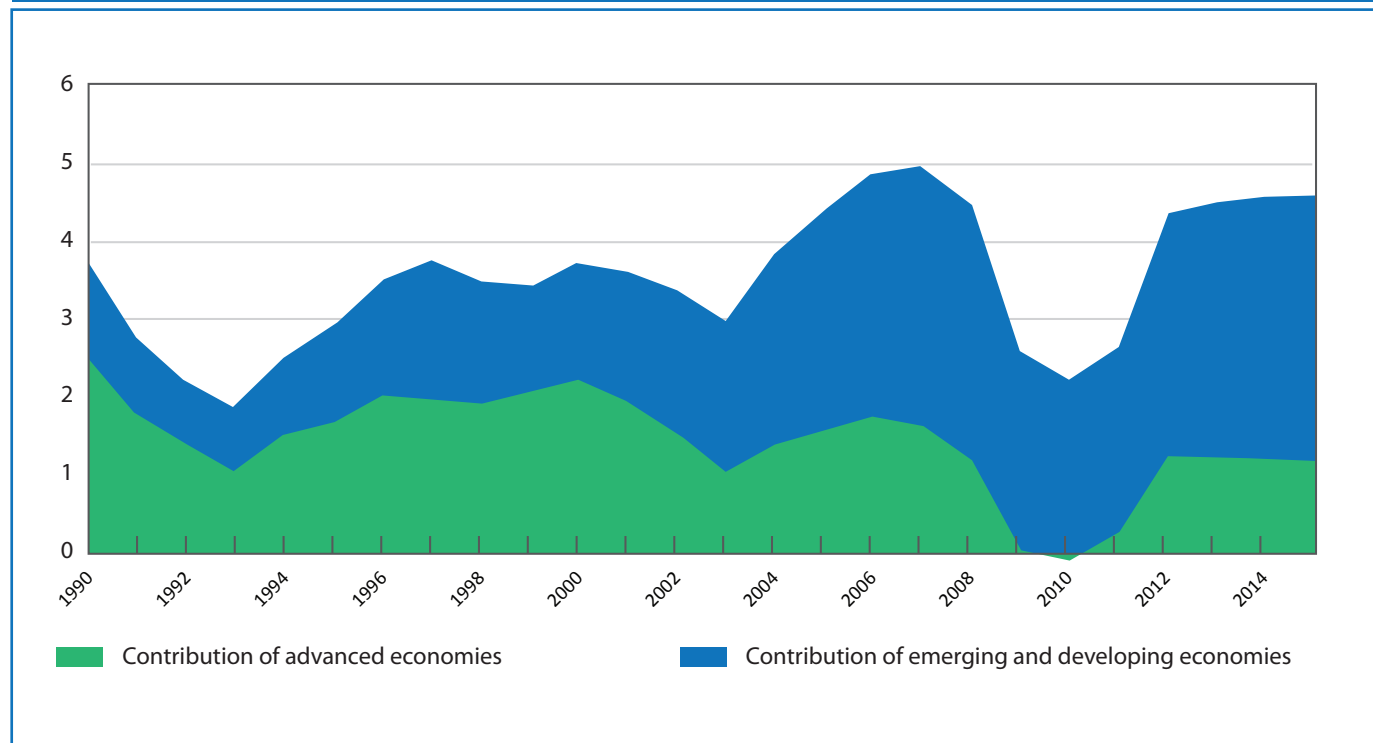
“Emerging powers in the developing world are already sources of innovative social and economic policies and are major trade, investment, and increasingly development cooperation partners for other developing countries” (Helen Clark, UNDP Administrator, 2013).

Over the past decade, the developing world has been driving global economic growth. Much attention has focused on

At the same time, this economic expansion has been neither uniform nor always inclusive. Some countries – in particular the poorest and some small countries – still struggle to secure adequate voice and representation in the international arena. And, while inequality *between* countries has declined, *within* them it has often increased (Oxfam, 2014). Multiple studies have shown that progress towards the MDGs has been faster in the richest quintiles than it has been in the poorest (UN, 2013c; UNICEF, 2010). The MDGs may have been achieved in *aggregate terms* in many countries, but there are still populations *within* them that have not benefited from development progress. Indeed, most of the world's extreme poor are now located within *middle-income* countries, not within the *poorest* countries (Sumner, 2011; 2012).

There are also countries in specific – and diverse – situations that continue to present special and longstanding development challenges. These include fragile and conflict-affected states, land-locked countries and small vulnerable economies. Some of these are classified as low-income; others are middle-income or even upper-middle-income. Some are major recipients of IPF; others are not. Most continue to experience severe structural constraints in their efforts to raise more domestic resources (owing to, for example, geographical features, small populations, limited natural resources, weak governance, conflict/post-conflict situations) and/or cannot access international capital markets (either at all or at an affordable rate).

Fig. 3: The developing world has been driving global growth



Source: Mold A. (2011). Annual GDP-PPP growth rate (based on 3-year moving average)

### 3.3 Fostering sustainable development

The major economic and political transformations described above are taking place at a time when the concept of “sustainable development” is emerging as the major framework for development thinking and practice, replacing or rebalancing the tight focus on poverty reduction and social progress under the MDG framework. One of the most important implications of this change is that the problem now being discussed (unsustainable development) is located in *all* countries. Addressing it will require profound structural transformations across countries of *all* income levels with differentiated levels of responsibilities. This will require the mobilization of unprecedented levels of finance over the *long term* and collective international action on an immense scale.

Climate change is affecting *all* countries. Building long-term resilience to its effects (such as severe floods, droughts and storms) will be essential across countries at *all* income levels. However, it will be even more important in those countries that are the most vulnerable and that have limited capacities to prepare for, and absorb, the effects of climate-related events. If measures are not taken to mitigate and adapt to climate change, this could undermine development progress and exacerbate inequalities for decades to come.

It is also generating considerable risks and uncertainties. The impacts of increases in temperatures (themselves uncertain) are unclear across countries and over time. However, the range of published evidence indicates the net damage costs of climate change are likely to be significant and are increasing (see, for example, IPCC, 2014). The 2006 Stern Review estimated that the overall costs of climate change will be equivalent to losing at least 5 per cent of global GDP each year; if more dramatic predictions come to pass, the cost could be more than 20 per cent of global GDP (Stern, 2006). This requires us to think about how to manage growing risks, vulnerabilities and uncertainties in the world on a *long-term basis*.

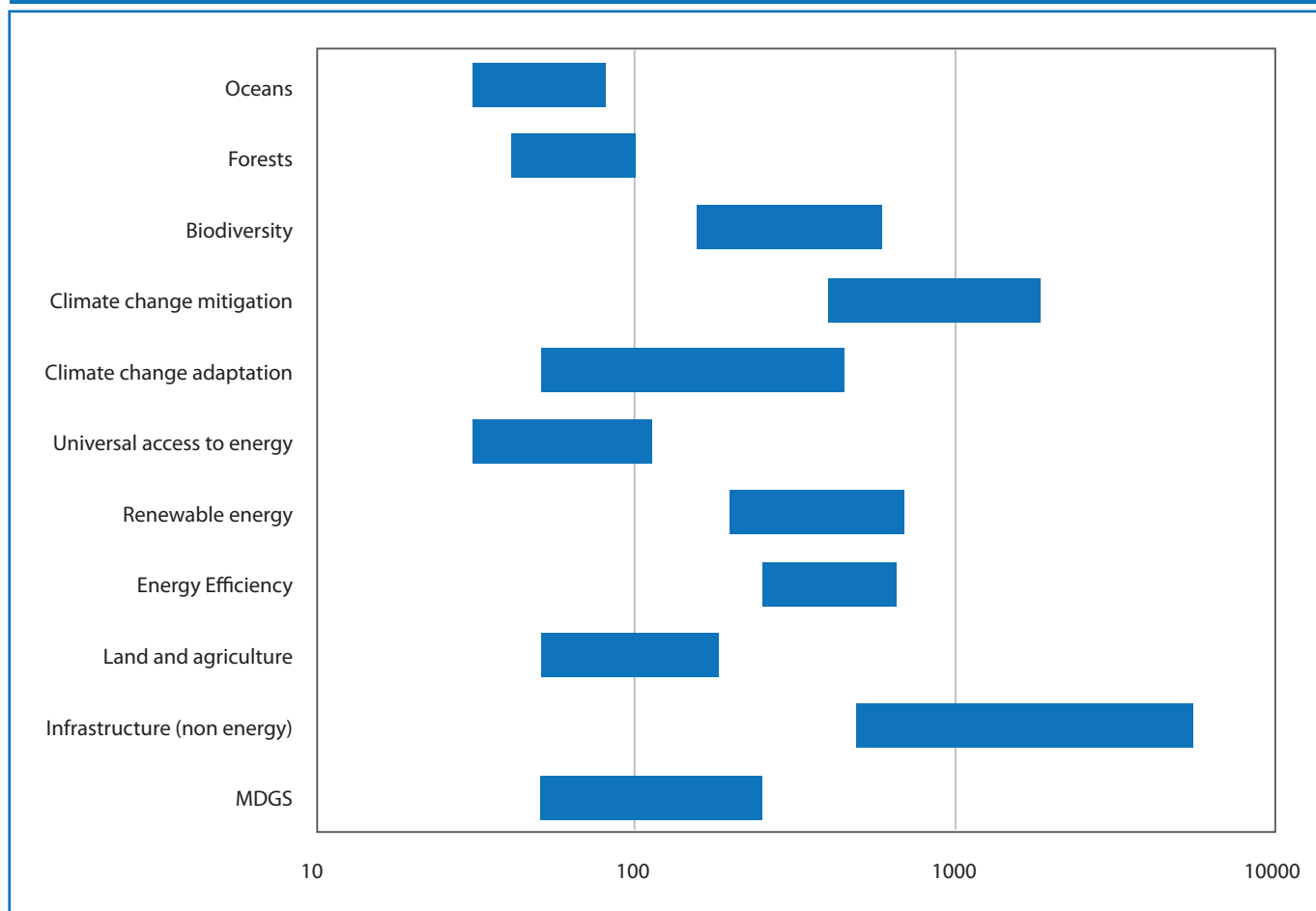
Preservation of the world’s ecosystems (such as forests and oceans) will become even more critical in the post-2015 period. Estimates as to the annual financing needs for these areas across countries at *all* income levels diverge, but are invariably high. Removing distortions such as subsidies to major polluting and resource-depleting activities (e.g. to the extractive industries, fertilizers, pesticides and land etc.) that undermine sustainable development could help redirect *existing* resources to more sustainable uses. But more resources will also need to be invested in maintaining and improving the world’s precious ecosystems. There are, however, often few incentives to do this, since, under the current economic system, these are not compensated for on a systematic basis.<sup>12</sup>

In parallel, convergence with the industrialized high-income world via traditional carbon-intensive forms of industrial development is being pursued. The need for a major step-change in infrastructure development across large parts of the world to fuel economic development as well as fulfil essential human needs is well recognized. With populations growing, some estimates suggest annual spending on infrastructure in the developing world needs to increase to US\$ 1.8-2.3 trillion each year by 2020.<sup>13</sup>

Yet the need to live within “planetary boundaries” calls into question the whole idea of convergence that has inspired development thinking and practice for the past five decades. What is needed is for all countries to take a different path towards progress, one that is compatible with the earth’s environmental limits (Oxfam, 2012).

The three pillars of sustainable development – economic growth, environmental stewardship and social inclusion – must all work in the same direction (UNDP, 2012). Sustainable development must drive forward human development, and reduce inequalities between and within countries, while also safeguarding the planet. It is a *universal* agenda that impresses on countries at all income levels the need to make major structural changes to their current development trajectories.

**Fig. 4: Order of magnitude of investment needs for sustainable development (US\$ billion per year)**



Source: UN (2013).

### **3.4 The implications for development aid and international public finance in the post-2015 era**

Broadening appreciation of the sustainable development challenges the world faces, combined with major structural shifts in wealth and political influence over the past decade, has important implications for development aid and IPF in the post-2015 era.

Increased wealth in the world means more countries will be able to contribute increasing resources to IPF in the future (and indeed this is already happening). More finance could therefore be made available to address major global concerns. This is good news. However, it also implies that serious efforts will need to be made in the post-2015 era to make the overall architecture for IPF more coherent, up-to-date and representative; we cannot expect middle- (and even low-) income countries to contribute greater sums to IPF within current unrepresentative institutional arrangements. Moreover, the developed world has, for the most part, failed to honour its pledges to increase development aid and to provide additional resources for climate change adaptation and mitigation.



***“As long as we are willing to continue investing in experimentation, research, and evaluation and build on this knowledge base, we will be able to meet the development challenge”***

*(Stern, 2006)*

A more nuanced and complex range of development situations has now replaced a simplistic division of the world into “developed” and “developing”. This means countries’ individual development challenges, vulnerabilities and long-term prospects are often not well captured via crude measures such as income per capita. This suggests a need to develop more tailored approaches to determining *how much* external financial support as well as *what sorts* of financing instruments will be most appropriate to different countries.

Meanwhile, the need to scale up environmental responses in the post-2015 era will require major changes in investment priorities, with a bigger role for longer-term and riskier expenditures. Funding for new technologies, research, science and innovation will be essential – and will need to be scaled up – to drive the structural economic transformation needed. Major investments in sustainable infrastructure will be needed in countries across *all* income levels. It will also be important to increase the capacities of developing countries to select, absorb, adapt and use imported knowledge and technologies, as well as to develop and improve *traditional* and *home-grown* knowledge and techniques (Sagasti, 2004; 2012).

International resources will need to focus on supporting the transition to more sustainable low-carbon models of development as well as building climate resilience and funding GPGs. International cooperation will be essential and income per capita will be a less relevant determinant of countries’ eligibility for international public funds; instead, a major factor will be where resources will have the biggest impact at the lowest cost (Birdsall, 2013).

Meanwhile, there are still those countries that, for some time to come, will require sustained international support to provide even the most basic social services to their citizens. It will be important to ensure no reduction in development aid to these countries as expenditure is scaled up in other areas, if extreme poverty is to be eliminated. Indeed, if many of the world’s poorest people become concentrated in so-called “fragile states”, as predicted, development aid will need to focus not on countries where there is “reasonable governance” (i.e. the current focus) but where it is weak to non-existent (Kharas and Rogerson, 2012). This will pose enormous challenges for development partners.

There is therefore an inherent tension between the desire to focus aid on the poorest and the need to allocate more and more resources to GPGs. This raises important questions as to whether it is appropriate to use development aid budgets to fund all these areas (as is current practice) or not. As financing for GPGs, climate-related interventions, research and other areas is scaled up in the post-2015 era, we also need to ask whether terms such as “development aid” and “ODA” are still relevant and accurate descriptions of what is being undertaken. Some interventions will indeed have positive developmental impacts, but often “development” will not be the sole or main purpose of the funding, and there will be benefits for both developed and developing nations alike (UN, 2013a).<sup>14</sup> This, in turn, means the “donor–recipient” paradigm that has dominated the aid discourse is less valid. We also need to ask whether it is more effective to use bilateral or multilateral approaches to meet these challenges and whether the institutional arrangements we have devised to deliver development aid are also suited to delivering on GPGs.

The sustainable development challenges we face are enormous. However, there are also unprecedented opportunities for joint working at the international level. In the next section, we explore how the traditional development aid paradigm could be made more relevant for the post-2015 era and beyond.

## Box 1: Economic disparities and the knowledge divide

More resources are needed to bridge the knowledge divide and to create endogenous science and technology capabilities in developing countries.

### Economic disparities and the knowledge divide (2007 or most recent year)

Indicator	Values and ratios		
	A) OECD countries	(B) LICs	Ratio (A)/(B)
GDP per capita (constant 2000 US\$)	24,645.6	351.7	70.0
Gross capital formation per capita (constant 2000 US\$)	4,577.6	87.1	52.5
Trade per capita (imports + exports of goods and services) (constant 2000 US\$)	13,286.5	171.8	77.3
Scientific output: scientific publications per 100,000 inhabitants	501	0.2	2505
Technological output: patent applications by residents per 100,000 inhabitants	66.7	0.03	2223.3
Production output: high-technology exports per capita	961.1	0.1	9611.0

Source: World Bank Global Indicators (LICs, as defined by the World Bank, with an average income per capita of less than US\$ 1,005 in 2010).

Source: Sagasti (2004; 2012).



## 4. PAYING FOR POST-2015 AND BEYOND: INTERNATIONAL PUBLIC FINANCE FOR SUSTAINABLE DEVELOPMENT

*“Mutuality of benefit should characterize multilateral relations; short-term and small-scale aid is being offered where longer-term investments are required; and compassion is being shown where ‘getting the price right’ would be the more appropriate way of dealing with financing issues like, for example, the issue of compensating countries for the most valuable global service of reducing greenhouse gas emissions – beyond what they would do, if they were to follow just national interests”*

*(Kaul, 2014)*

Rising wealth should not be seen as a reason to wind down development aid; meeting the scale of the sustainable development challenge will require the mobilization and reallocation of *unprecedented* amounts of resources. This financing will also be needed over a *long-term* time horizon. Although the private sector will be an important contributor, a significant chunk will need to come in the form of IPF, which should spearhead investments in particular directions as well as correct for massive market failures. The specific characteristics of IPF make it important for all countries in the post-2015 era, not just the poorest.

Most of the resources required will *not*, however, take the form of traditional development assistance. A diminishing number of countries – low-income, vulnerable, fragile, post-conflict – will still require traditional development aid in the post-2015 period. But for others – across all income levels – interventions in areas such as research, new technologies, sustainable infrastructure, climate change adaptation and mitigation and financing for GPGs will be the main focus, and these will need to be scaled up in the post-2015 era. Public and private, domestic and external, resources will all be important, but IPF will play a central role in driving forward a coherent international approach to these challenges.

In this context, it is important to think about whether terms such as “development aid”, “development assistance” and “ODA” are still relevant for the post-2015 era. Can this term be used to describe the broad range of functions IPF needs to perform in the post-2015 era?

IPF must, in turn, be made more effective and be better targeted in the post-2015 era, allocating resources on the basis of individual countries’ specific circumstances and needs, as well as in line with internationally agreed sustainable development priorities. Also, what measures can be taken to reliably scale up the volume of IPF we raise over the long term?

Larger and more complex flows of funds provided by a broader set of countries will require an unprecedented level of cooperation among governments, as well as better and more legitimate institutions to manage these flows.

So, in practical terms, what steps could be taken within a post-2015 sustainable development agreement to make the current development aid business model more relevant for changing times?

## 4.1 “Beyond aid”: new times, new concepts

Words matter. The terms “development aid”, “development assistance” and “ODA” have all been used (largely interchangeably) to describe a wide range of interventions in the developing world over the past five decades. Some of these interventions have supported important development progress; in other cases, political, commercial or other motivations have been more important.

The term “ODA” was developed by a distinct set of high-income countries (OECD DAC members), and, to a large extent, the definition reflects the interests of, and a compromise between, these donors (Hynes and Scott, 2013). It allows, for instance, climate-related interventions and other contested areas to be counted as development aid. The OECD also decides which countries are eligible, or not, to receive development aid. Despite these limitations, however, the OECD DAC ODA definition has become the only international benchmark for assessing official financial flows to the developing world (Severino and Ray, 2009).<sup>15</sup> Meanwhile, the term “South–South Cooperation” has emerged to describe a heterogeneous mix of aid- and non-aid-like interventions emanating from developing countries themselves (UNDP, 2013).

The simplistic concept of “development aid” is now under considerable pressure. As incomes across the developing world rise, and as development aid budgets are increasingly tapped to fund GPGs and climate change adaptation and mitigation, it is important to ask whether the broad range of functions IPF is *already performing* can be described – and *counted* – as development aid. For instance, funding for GPGs – and also climate change mitigation – is as much an investment in the *common* interest as a transfer from “rich” to “poor”. Funding for some of these areas is likely to be needed over the long term.

“Development aid” or ODA is, in fact, a subset of a larger and much more relevant idea: *international public finance for sustainable development* – or IPF4SD. We distinguish IPF from IPF4SD by the objectives. The former broad category includes all public monies spent overseas, irrespective of the objective, whereas the latter refers only to the IPF that furthers internationally agreed sustainable development objectives.

While traditional development aid will remain important to some countries in the post-2015 era (and therefore needs to be protected and strengthened), it will also be essential to scale up cross-border collaboration and international public spending in areas such as research, new technologies, sustainable infrastructure, environmental conservation and climate change adaptation and mitigation. It is these flows that will acquire more prominence and that are likely to constitute the bulk of official development finance transactions in the post-2015 era. Such flows can be gathered under the label of IPF4SD. This finance will help usher in new paths to sustainable and inclusive development for *all* countries in the post-2015 era.<sup>16</sup>

The transition from a “development aid” or ODA regime towards an IPF4SD regime raises many challenging questions. For instance, how much IPF4SD is needed in different areas (such as “traditional” development aid, climate finance, GPGs or research, new technologies etc.), and should there be international targets for different forms of IPF4SD? Should *all* countries contribute something to IPF4SD? How should contributions reflect the principle of common but differentiated responsibilities? What does this approach mean for existing commitments on development aid such as the pledge to allocate 0.7 per cent of GNI to ODA or those on climate finance? How should IPF4SD be allocated across countries and what would be the most effective institutional arrangements to mediate such finance (see Section 4.3 for further discussion)?

At the same time, it will also be important to accurately *define* and measure contributions to IPF4SD. The OECD DAC is spearheading an important discussion between its members on the “development aid” definition. This may lead to a new broader measure, possibly called “official development effort”, from 2015.<sup>17</sup> However, it will be important for *all* countries to have a stake in defining what should be measured, and how. This in turn raises issues as to which international entities should be tasked to monitor and report on states’ contributions to IPF4SD.

Of course, it is not just about increasing the *volume* of resources available for IPF4SD; the *quality* of these funds also matters. The OECD-led initiative on aid effectiveness – which encourages donors to revise their aid practices so as to increase the impact on development – has been the most valuable initiative to date in this area.<sup>18</sup> The Global Partnership for Effective Development Cooperation has, in turn, attempted to bring more actors on board with this agenda (in particular emerging donors, civil society actors and the private sector).<sup>19</sup>

Yet these processes still remain founded on the norms and principles on aid effectiveness established by the OECD DAC donors; some “emerging” donors argue that these commitments are not applicable to them. In the post-2015 era, it will therefore be important for *all* countries to be involved in establishing the international norms, standards and objectives for IPF4SD. The challenge will be, of course, to avoid a “race to the bottom”.

### **Box 2: The uneasy relationship between development aid and climate finance**

There is one important area of IPF that is non-voluntary in nature: financing for climate change adaptation and mitigation. The UN Framework Convention on Climate Change (UNFCCC) (1992), the Kyoto Protocol (1997) and the Copenhagen Accord (2009) all call for developed countries to provide, “new and additional” climate change financing to developing countries. The term “new” refers to the fact that the funds should represent an increase on past and existing climate-related funds. The term “additional” refers to the idea that financial resources raised for one objective, such as climate change, should not substitute for or divert funding from other important objectives, in particular international development.

Despite a decade of attempts to define additionality, the concept continues to be poorly understood and its application contested.

Under one definition, climate finance is classified as aid, but should be additional to (over and above) the 0.7 per cent ODA target. Another takes 2009 disbursements on climate actions as the reference point (the year of the Copenhagen Accord) and contends that any climate-related finance above this amount can be considered additional. A further definition suggests a complete separation between ODA and climate change finance. Each has different implications for the resource envelope available for both “classic” development activities and climate-related actions.

In practice, additionality is virtually impossible to prove. Developed countries typically report climate-related actions as ODA. The pressure to use an increasing share of IPF for climate change adaptation and mitigation as well as other GPGs could lead to declines in poverty-focused aid, unless the overall envelope expands to respond to the expanding set of sustainable development objectives.

## 4.2 Mobilizing international public finance for sustainable development

The case for scaling up financing for climate change adaptation and mitigation, as well as for GPGs (e.g. to protect forests and oceans etc.) in the post-2015 era is clear. The case for scaling up financing to other areas, such as science, new technologies and innovation, agriculture and sustainable infrastructure development, has also been made. Interventions in *all* these areas will be needed over a *long-term* time horizon.

There are also those countries that present longstanding development challenges that will continue to need traditional forms of development support for some time to come.

The need for scaled-up, continuous finance over the *long term* raises issues as to how these resources can reliably be raised. New approaches and new instruments will be required.

Despite recent (and welcome) increases in development aid, most OECD DAC donors have never met the longstanding target to allocate 0.7 per cent of GNI to development aid; in 2012, the shortfall against this target was more than US\$ 174 billion (or 0.41 per cent of GNI) (UN, 2013b).<sup>20</sup>

Innovative sources of development finance, although small in scale to date, could be scaled up in the post-2015 era to help raise stable and core resources for IPF.<sup>21</sup> Options include developing financial transactions taxes and/or carbon taxes as well as leveraging the IMF's Special Drawing Rights (SDRs) in support of sustainable development. Some initiatives could help address misaligned incentives at the same time (e.g. carbon taxes).

Political agreement on *large-scale* coordinated international schemes such as these has so far proven elusive, although there are important small-scale precedents.<sup>22</sup> Estimates as to the amounts of revenues that could be raised via initiatives such as financial transactions taxes and carbon taxes are, however, high (see table 2).

In this context, the post-2015 sustainable development agreement provides an opportune moment to revisit international discussions over these ideas. In the new post-2015 agreement, governments could commit, for instance, to experimenting on a *voluntary* basis with coordinated innovative taxation schemes. Governments could also pledge to use the tax(es) (or specified portions) for international cooperation.<sup>23</sup> The portion allocated to IPF4SD could, in turn, be differentiated between countries according to income level or other criteria. There are also opportunities for world regions (e.g. Africa, Asia, Latin America etc.) to experiment with their own *regional* innovative financing for development schemes, as the European Union is doing with a financial transactions tax.

In parallel, governments need to think about how voluntary commitments on IPF4SD can be made more stable and predictable in the post-2015 era. Is setting international targets the most effective approach for reliably mobilizing the resources needed for IPF over the long term? Are (differentiated) targets relevant for countries at all income levels? What are the lessons learned from peer review mechanisms such as the one practised by the OECD to monitor its members' aid levels on an annual basis? Are there alternatives to moral suasion combined with periodic peer review processes? The post-2015 process is an important opportunity to try to move forward international discussions on these issues, and governments could commission independent studies into some of these questions.

As these issues are debated, it will, of course, be important for high-income countries to meet historical and longstanding targets on development aid. This will not only raise much-needed resources for investments in a range of key areas, but also will send a powerful message of commitment to the post-2015 sustainable development agreement.



Table 2: Selected innovative financing for development mechanisms

Mechanism	Description	Revenues raised	Funding purpose/beneficiaries
<b>Solidarity Levy on Airline Tickets</b>	A coordinated tax on airline ticket sales. Launched in 2006.	US\$ 1 billion between 2006 and 2011	Collects funds for UNITAID and IFFIm (HIV and AIDS, tuberculosis and malaria and several other communicable diseases)
<b>International Finance Facility for Immunization (IFFIm)</b>	Raises funds by issuing bonds in international capital markets. Repays bondholders with the long-term ODA commitments of donor governments.	US\$ 3.4 billion between 2006 and 2011	IFFIm funds are channelled to the GAVI Alliance
<b>Advance Market Commitments (AMC) for a pneumococcal vaccine</b>	Donors commit funds to guarantee the price of pneumococcal vaccines. These financial commitments provide incentives to vaccine manufacturers to develop a product and to manufacture it at scale.	US\$ 1.5 billion donor commitment in total	Pneumococcal vaccine
<b>2% share from the sale of Certified Emissions Reductions (CERs)</b>	A 2% levy on carbon credits generated through the Clean Development Mechanism is channelled to the Adaptation Fund, which finances climate adaptation projects and programmes in developing countries.	US\$ 70 million	Climate adaptation projects
<b>Financial Transaction Tax (FTT)</b>	A tax on specific types of financial transactions such as currencies, shares, bonds and derivatives. Numerous countries implement FTTs at the national level. 12 countries of the EU plan to implement a coordinated FTT from 2014.	<i>Proposed. Estimates range from US\$ 33 billion to US\$ 650 billion per year at the global level</i>	Domestic purposes. No funds committed to international development (except France with a commitment to allocate 10% of revenues raised)
<b>Carbon taxes</b>	A tax on the carbon content of fossil fuels (such as coal, oil and gas) designed to provide businesses and individuals with an incentive to curb activities that produce CO <sub>2</sub> emissions while also raising revenues.	<i>Proposed. Estimates range from US\$ 48 billion to US\$ 250 billion each year</i>	
<b>Special Drawing Rights (SDRs)</b>	The SDR is an international reserve asset created by the IMF to supplement its member countries' official reserves. SDRs are created by the Executive Board of the IMF and can be allocated to member countries in proportion to IMF quotas.	US\$ 250 billion in SDRs was created in August 2009. Allocated to members in proportion to IMF quotas	Direct budget support. A Green Fund capitalized in part with SDRs has also been suggested (IMF, 2010)

Source: Authors' adaptation from UNDP (2012).



### **4.3 Improving the architecture for international public finance in the post-2015 era**

IPF4SD must be much better targeted in the post-2015 era, and the architecture that mediates these funds made more efficient and representative.

Decisions on how to allocate development aid are, as we have seen, influenced by multiple political, commercial and moral considerations. In practice, this means development aid sometimes does not reach those countries and/or populations most in need. Most donors still prefer to use bilateral rather than multilateral aid channels, in part because it affords them greater control over how and where funds are used. As the number of actors involved in international development expands, however, the development aid architecture has become messier and more complex to navigate.

Income per capita also influences aid allocation decisions. The assumption is that, at higher income per capita levels (at thresholds determined by development agencies), countries are able to mobilize more domestic and external resources for development. This assumes these resources are substitutes (or near perfect substitutes) for official development aid.

Are these approaches well suited to addressing the most important sustainable development challenges of the post-2015 era? Are the institutional arrangements the world has devised for mediating development aid also suited to delivering other forms of IPF, such as funding for climate change adaptation and mitigation, for GPGs or for research and new technologies? What are possible alternatives?

#### **4.3.1 From graduation to gradation**

Income per capita influences decisions on how and where to allocate development aid, in particular from the multilateral development agencies. However, despite similar income per capita levels, the data show countries can have extremely differentiated capacities to mobilize domestic and external resources for sustainable development (see Figure 6).

For instance, small countries such as Armenia, Cape Verde and El Salvador all have similar income per capita levels to the much larger Indonesia (at between US\$ 3350 and US\$ 3700 in 2012 – World Bank, 2013a), but the smaller countries struggle to attract and leverage private external resources.

Countries at similar income levels also face diverse sustainable development challenges and/or specific vulnerabilities; the challenges facing the Maldives, for instance (with a per capita income of US\$ 6,567 in 2012), could not be more different to those facing Iraq (with a similar per capita income level, at US\$ 6,455 in 2012).

And, while it may be useful to consider income per capita in the allocation of “traditional” development aid, it is a less relevant tool for determining eligibility for, and access to, other forms of IPF; the latter has a different rationale and project allocation logic.

What are the possible alternatives?

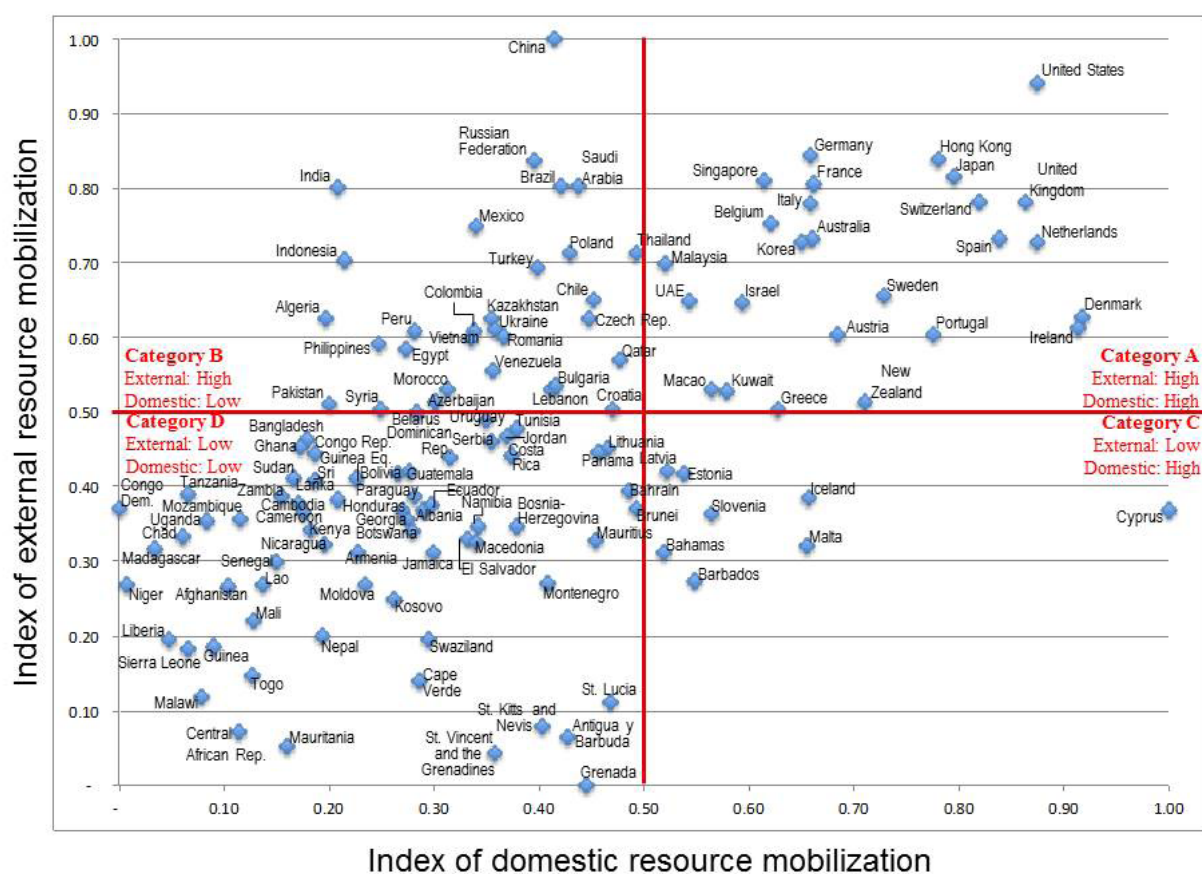
One option is to base the choice of financing instruments and the allocation of IPF4SD on countries’ capacities to mobilize domestic and external resources. The mix of concessional and non-concessional resources would be tailored to countries’ specific circumstances (Sagasti et al., 2005; 2013).<sup>24</sup>

In addition to income per capita, this approach would combine indicators on domestic resource mobilization capacities (i.e. domestic savings, tax revenues, the fiscal deficit, bank credit and gross fixed capital formation), with indicators on access to external resources (FDI, IPF inflows, international reserves and exports), to arrive at an index that provides a more holistic picture of countries' specific development financing requirements. It implies financing decisions are made on a case-by-case basis and no countries are considered *de facto* ineligible for IPF4SD; different countries will need and use IPF4SD for different purposes.

Other criteria also matter above and beyond financial indicators. These include vulnerabilities to climate change and other economic vulnerabilities such as those contained in UNEP's Environmental Vulnerability Index (EVI).<sup>25</sup> Allocation decisions could also take into account social indicators such as those contained within the UN Development Programme (UNDP) Human Development Index (HDI) or the UN's Human Assets Index (HAI).<sup>26</sup>

There is a role for the post-2015 agreement to seek a consensus on the need to revise current approaches to graduation and to replace them – within a specified timeframe – with more tailored criteria for the allocation of *IPF4SD*. Governments could commission independent expert opinions to develop options for discussion at the international level.

Fig. 5: Countries' domestic and external resource mobilization capacities



Source: Sagasti et al. (2005; 2013).

### 4.3.2 Towards a new multilateralism

The current architecture for international development comprises countless institutions and organizations that overlap and duplicate in mandate and operations. It is complex and difficult to navigate and can best be described as a “non-system” for international cooperation and development (Bezanson and Sagasti, 2005). Some of the most important institutions that mediate IPF – the World Bank and the IMF – underrepresent the developing world.

The “scaffolding” matters. If the new sustainable development agreement is to have the strongest possible chance of success, important changes will be needed in the architecture that mediates IPF, to make it much more coherent, efficient and representative.

Bilateral channels are still preferred when it comes to delivering development aid. But it is not clear that this instrumentation represents the first-best option when it comes to delivering financing in other areas, such as climate change adaptation and mitigation, research and new technologies and GPGs; international coordination and cooperation are likely to produce better results.

In practical terms, this implies a greater role for large-scale pooled disbursement arrangements in the post-2015 era. Large-scale international funds in areas such as climate change adaptation and mitigation, science, research and new technologies, infrastructure development, agriculture and nutrition and GPGs could all have an important role in underpinning the structural transformation needed to move the world towards a more just and sustainable future.

Pooled funds could allow for the development of economies of scale and help reduce administration costs, improve efficiencies, increase knowledge and expertise and enable a wide range of financing instruments to be used and disbursed. Such mechanisms could also help leverage finance from the private sector as well as ensure IPF supports shared international objectives.

Strengthened global action does not, however, require new global initiatives or new global vertical funds. Instead, it requires the *consolidation and continuous improvement* of large-scale multilateral initiatives combined with a commitment from countries to channel increasing resources through these mechanisms (specific targets to be achieved within a specified timeframe could be established). A willingness to experiment with new configurations and learn from these experiences will be required. Ongoing difficulties with the resourcing and structure of the Green Climate Fund demonstrate how difficult this approach can be; on the other hand, there are also recent innovations to learn from – some better than others – such as the GAVI Alliance and the Adaptation Fund.<sup>27</sup>

Governance will be critical to the effective (and legitimate) performance of such multilateral funds. Governance arrangements will need to be representative and inclusive, and secretariats well resourced. International norms and standards will also need to be built-in, such as alignment behind national sustainable development priorities, local ownership, transparency and accountability for the use of funds.

The approach suggested will also require a thorough review of the mandates, governance structures and effectiveness of *existing* multilateral institutions and initiatives, at both international and regional levels, including the Bretton Woods institutions.

The post-2015 process represents, above all, a chance to build development finance institutions that represent all constituencies, are well resourced and deliver high-quality finance that supports internationally agreed objectives.

### Box 3: Key attributes of an effective international development financing system

- Adequacy (match between development financing and needs of different countries)
- Predictability (amount, counter-cyclical funds)
- Responsiveness (balance needs vs. performance)
- Diversity and choice (variety of instruments, needs and programmes)
- Capacity to absorb shocks (rapid response)
- Complementarity to domestic resource mobilization
- Voice, representation and accountability
- Flexibility, adaptation and learning (with options for “sunset clauses” and mergers)

Source: Adapted from Sagasti and Prada (2010).



## 5. CONCLUSION

International collaboration on the post-2015 sustainable development agenda has shown there is a lot of interest – from a wide range of stakeholders – in building a shared vision for the future. As financing arrangements and possibilities are discussed, it is natural that development aid is in the spotlight, given its important role in the history of international development.

But it is impossible to discuss aid in the same way as it was discussed just a few years ago. Global shifts in economic wealth and political power combined with the onset of new challenges for the international community, most notably in the area of the environment, mean the world of “us” and “them” is definitively over, leaving traditional “donor–recipient” relationships hanging on somewhat incongruously.

In this discussion paper, we have laid out what is, in our view, a very strong case for international public finance for sustainable development (IPF4SD) to be established *over the long term* to help respond to present and future global sustainable development challenges. But in a very different way to before.

Building on the lessons, positive and negative, from the era of “development aid”, and retaining that concept for many ongoing development activities, IPF4SD emphasizes a common investment between equals in support of the common interest. Such a rebranding requires big thinking about the kind of effective and accountable governance regimes required to manage large amounts of money – we have set out some such thinking in this paper, but there is much still to be done.

This paper has outlined possible next steps in the international cooperation endeavour. Our ideas are intended to stimulate further debate. While this paper has looked at some of the “bigger picture” questions, more research will be needed to make the ideas tabled workable in practice. Some possible areas for further research include:

- What criteria should be used to devise appropriate contributions to IPF4SD? Should all countries contribute something? How can we ensure the principle of common but differentiated responsibilities is respected?
- Various systems already exist for raising resources for IPF. These include voluntary contributions, voluntary targets (such as 0.7 per cent ODA/GNI) and formal contributions (e.g. to parts of the UN and the IMF). Various mechanisms have also been devised to monitor countries’ compliance with both quantitative and qualitative voluntary targets. What are the strengths and weaknesses of different approaches, and what lessons can be learned for the future?
- Should there be targets to provide funding for specific issues and/or specific countries? There are already targets to raise specific amounts of development aid and climate finance. The MDGs also served to orient resources in specific directions. Targets also exist to allocate certain amounts of resources to countries in specific situations (e.g. the LDCs). What can these experiences teach us as we look to devise an effective IPF4SD regime?
- The longer-term incentives for making changes to the IPF4SD regime are clear, but what are the short-term barriers and constraints to change?
- What would our proposed changes mean in practical terms for bilateral development aid agencies today? What would they mean for multilateral institutions and organizations?

We welcome constructive feedback from all stakeholders on any of the suggestions tabled in this paper and hope the ideas here will encourage others to dive into some of these important questions.

A more effective regime for IPF will help underpin the structural transformation that needs to occur to put the world on a more just and sustainable path. Progress will be uneven and trial and error will be an inevitable part of this process. However, by the time the next set of international goals concludes, in 2030, the international community should have laid solid foundations for raising and mediating IPF4SD on a stable, effective and long-term basis.

Failing to do so will end up being by far the most costly option.



# ENDNOTES

1. For more information on the UN-led consultation on the post-2015 agenda, see UNDG (2013).
2. “Extreme” poverty is defined as those people living on less than US\$ 1.25 per day at 2005 purchasing power parity (PPP), a measure used by the World Bank.
3. In 2012, for the first time ever, developing countries absorbed more FDI than developed countries, at 52% of all FDI flows (or US\$ 703 billion) (World Bank, 2013a).
4. Since 1972, the OECD DAC has defined aid (or ODA) as official flows that have “the promotion of the economic development and welfare of developing countries” as the main objective and that are “concessional in character”. For a more detailed discussion of the evolution of the ODA definition, see Hynes and Scott (2013).
5. The OECD defines OOFs as “transactions by the official sector with countries on the list of aid recipients which do not meet the conditions for eligibility as Official Development Assistance or official aid, either because they are not primarily aimed at development, or because they have a grant element of less than 25 per cent.” See, OECD: <https://stats.oecd.org/glossary/detail.asp?ID=1954>
6. See for instance, Glennie and Hurley (2014).
7. Impact investments are investments made into companies, organizations and funds aimed at generating measurable social and environmental impact alongside a financial return. They can be made in both emerging and developed economies, and target a range of returns from below market to market rate, depending on the circumstances. For more information, see <http://www.thegiin.org/cgi-bin/iowa/home/index.html>
8. In the US, for example, the average holding period for stocks fell from eight years in the 1960s to six months in 2010 (UN, 2013b).
9. Following the 2008 financial crisis, resources to the IMF trebled to US\$ 750 billion. The size of the public sector response to the crisis was unprecedented in scale and was accompanied by additional public finance mobilized at the national level amounting to a US\$ 1.1 trillion programme of public financial support (G20, 2009). The major development banks were also bolstered. The African and Asian Development Bank’s capital increased by 200 per cent and the Inter-American Development Bank’s by 70 per cent. The World Bank received an overall increase of 30 per cent (Woods, 2013).
10. While ODA has reached its highest level ever in absolute terms, when measured as a proportion of gross national income (GNI) ODA from OECD DAC countries stood at 0.3 per cent of GNI in 2013. This is far from the UN target of allocating 0.7 per cent of GNI to ODA. For further information, see <http://www.oecd.org/newsroom/aid-to-developing-countries-rebounds-in-2013-to-reach-an-all-time-high.htm>
11. The proportion of the world’s US\$ 1.25 and US\$ 2 poor accounted for by middle-income countries is, respectively, 74 per cent and 79 per cent (Sumner, 2012)
12. Some schemes do exist, on an ad hoc basis, to provide compensation to governments, landowners or communities for maintaining natural ecosystems “intact” (or for improving them). But these do not occur on a systematic basis and are not to scale.
13. Current spending on infrastructure in developing countries is approximately US\$ 0.8-0.9 trillion per year, with domestic budgets financing the majority. The remainder is provided by a mix of private sector institutions, developed country ODA, multilateral development banks and, more recently, emerging economies such as the BRICS. For further information, see Bhattacharya et al. (2012).

14. For instance, through payments for ecosystem services, there are direct beneficiaries (the countries, communities and/or landowners involved) as well as indirect beneficiaries (the rest of us), who derive an indirect benefit from an improved environment.
15. For a more detailed discussion of these issues, see Hynes and Scott (2013) and Severino and Ray (2009).
16. Severino and Ray (2009) propose a measure to replace ODA called “global policy finance”. This would measure funding of the three core components of sustainable development, namely, 1) convergence between economies of the North and the South; 2) better access to essential services across the world; and 3) the provision of GPGs. For more details, see Severino and Ray (2009).
17. For insights into the ongoing discussions on modernizing the concept of ODA, see Lomoy (2013) and OECD (2013).
18. For more information on the OECD’s aid effectiveness principles, see <http://www.oecd.org/dac/effectiveness/parisdeclarationandaccraagendaforaction.htm>
19. For more information on the Global Partnership for Effective Development Cooperation, see <http://effectivecooperation.org/>
20. Countries that in 2013 achieved the UN’s 0.7 per cent ODA/GNI target were Denmark, Luxembourg, Norway, Sweden, the UK and the United Arab Emirates. The Netherlands has also consistently reached the 0.7 per cent aid target, although its aid decreased slightly below this level in 2013. For further information, see <http://www.oecd.org/dac/stats/documentupload/ODA%202013%20Tables%20and%20Charts%20En.pdf>
21. There is no internationally agreed definition of “innovative financing for development”. In reality, the term encompasses a heterogeneous mix of innovations in fundraising and innovations in spending, that is, innovative financing for development comprises both innovations in the way funds are raised as well as innovations in the ways funds are spent on international development (World Bank, 2009). For further discussion, see UNDP (2012).
22. Examples of important smaller-scale initiatives include the airline ticket tax, the International Finance Facility for Immunisation (IFFIm) and the 2 per cent tax on the sale of Certified Emissions Reductions (CERs).
23. In 2013, 12 countries of the European Union (EU) approved a proposal to implement a coordinated financial transactions tax (FTT) that aims at raising €35 billion per annum. Yet, to come into effect, the tax would charge 0.1 per cent against the exchange of shares and bonds and 0.01 per cent across derivative contracts, if just one of the financial institutions resides in a member state of the EU FTT. There has, however, been no discussion about whether the proceeds of the tax (or a portion of it) will be used for international cooperation. Only France has committed to allocating 10 per cent of the revenues raised through the FTT to international development, and it is unclear whether this amount will be in addition to – or will substitute for – the budget normally allocated to development aid.
24. For a brief discussion of these issues, see Sagasti (2013).
25. The EVI utilizes 50 indicators to capture the key elements of environmental vulnerability. These include: exposure to extreme weather events, isolation, population and migration dynamics, conflict, environmental degradation and others. For more detailed information on the EVI, see: <http://www.vulnerabilityindex.net/index.html>
26. The HDI combines indicators of life expectancy, educational attainment and income, and, in so doing, constructs a more holistic picture of social and economic progress at national and subnational levels. For further information, including country “scores” under the index, see <http://hdr.undp.org/en/statistics/hdi>. The UN’s HAI is a combination of four indicators: two indicators of health and nutrition and two of education. For further information, see [http://www.un.org/en/development/desa/policy/cdp/ldc/ldc\\_criteria.shtml#hai](http://www.un.org/en/development/desa/policy/cdp/ldc/ldc_criteria.shtml#hai)
27. For further information, see <http://www.gavialliance.org/> and <https://www.adaptation-fund.org/>



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